

BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

JANUARY 14, 2002

IN RE:

JOINT PETITION OF UNITED TELEPHONE-
SOUTHEAST, INC. AND AT&T COMMUNICATIONS
OF THE SOUTH CENTRAL STATES, INC.

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DOCKET NO.
00-00701

ORDER DENYING
JOINT PETITION OF UNITED TELEPHONE-SOUTHEAST, INC.
AND AT&T COMMUNICATIONS OF THE SOUTH CENTRAL STATES, INC.

This matter came before the Tennessee Regulatory Authority ("Authority") at a regularly scheduled Authority Conference held on February 21, 2001 upon the *Joint Petition of United Telephone-Southeast, Inc.* ("UTSE") and *AT&T Communications of the South Central States, Inc.* ("AT&T") (hereinafter "*Joint Petition*"). Through the *Joint Petition*, the parties seek to: (1) increase Local Service rates; (2) reduce access charges; and (3) forego Universal Service funding. After reviewing the *Joint Petition* and associated filings in this matter, the Directors voted unanimously to deny the *Joint Petition*.

Background

In May of 1995, the Tennessee General Assembly enacted legislation that opened up the local telecommunications market to unprecedented opportunities for competition and established a new regulatory structure for the regulation of telephone companies¹ designed

... to foster the development of an efficient, technologically advanced, statewide system of telecommunications services by permitting competition in all telecommunications services markets, and by permitting alternative forms of regulation for telecommunications services and telecommunications services providers.²

¹ See 1995 Tenn. Pub. Acts, ch. 408, codified at Tenn. Code Ann. §§ 65-4-101, -123 & -124, 65-4-201, -203, -207, and 65-5-208 to -213 (Supp.1996); *BellSouth Telecommunications, Inc. v. Greer*, 972 S.W.2d 663, 666-67 (Tenn. Ct. App. 1997).

² Tenn. Code Ann. § 65-4-123.

As part of this restructuring, the General Assembly mandated the provision of the universal availability of basic telephone service to Tennessee citizens at affordable rates.³ The basic parameters of the State's Universal Service requirements were established in Tenn. Code Ann.

§ 65-5-207(a) as follows:

Universal service, consisting of residential basic local exchange telephone service at affordable rates and carrier-of-last-resort obligations must be maintained after the local telecommunications markets are opened to competition. In order to ensure the availability of affordable residential basic local exchange telephone service, the authority shall formulate policies, promulgate rules and issue orders which require all telecommunications service providers to contribute to the support of universal service.

Pursuant to Tenn. Code Ann. § 65-5-207(c), the Authority has the flexibility to establish "an alternative universal service support mechanism" upon determining that such an alternative would protect consumers, be fair to telecommunications service providers and preserve universal service. This flexibility is not without limitations, however, as this statute provides a list of specific requirements to be followed in the event that an alternative universal service support mechanism is created.⁴

³ See *Greer*, 972 S.W.2d at 667 (citing Tenn. Code Ann. §§ 65-5-207, 208 (Supp. 1996)).

⁴ Tenn. Code Ann. § 65-4-207(c) states:

The authority shall create an alternative universal service support mechanism that replaces current sources of universal service support only if it determines that the alternative will preserve universal service, protect consumer welfare, be fair to all telecommunications service providers, and prevent the unwarranted subsidization of any telecommunications service provider's rates by consumers or by another telecommunications service provider. To accomplish these objectives, the authority, if it creates or subsequently modifies an alternative universal service support mechanism, shall:

- (1) Restrict recovery from the mechanism by any telecommunications service provider to an amount equal to the support necessary to provide universal service;
- (2) Consider provision of universal service by incumbent local exchange telephone companies and by other telecommunications service providers;
- (3) Order only such contributions to the universal service support mechanism as are necessary to support universal service and fund administration of the mechanism;
- (4) Administer the universal service support mechanism in a competitively neutral manner, and in accordance with established authority rules and federal statutes;
- (5) Determine the financial effect on each universal service provider caused by the creation or a modification of the universal service support mechanism, and rebalance the effect through a one-time adjustment of equal amount to the rates of that provider;
- (6) When ordering a modification, include changes in the cost of providing universal service in the rebalancing required by subdivision (c)(5);
- (7) When performing its duties under subdivisions (c)(5) and (6), order no increase in the rates for any interconnection services; and
- (8) Consider, at a minimum:

Prior to the enactment of Chapter 408 in 1995, the Tennessee Public Service Commission ("TPSC"), the predecessor agency to the TRA, would conduct an investigation and hold a hearing to determine whether local exchange carrier's requested increase in rate or rate of return was "just and reasonable." Chapter 408 established the new price regulation provisions under which a local exchange carrier could "adopt a 'price regulation plan' in lieu of the then existing method of setting and changing rates."⁵ Further,

Under the price regulation provisions of Chapter 408, "[r]ates for telecommunications services are just and reasonable when they are determined to be affordable as set forth in this section," and it is left to the TRA to "ensure that rates for all basic local exchange telephone services and non-basic services are affordable on the effective date of price regulation for each incumbent local exchange company." T.C.A. § 65-5-209(a). Once a company enters price regulation under the statutory scheme, T.C.A. § 65-5-209(e)-(g) govern the amount by which the company is permitted to change its rates. The change is determined by reference to a formula incorporating the national inflation rate.⁶

On June 16, 1995, UTSE elected to become a price regulated company pursuant to Tenn. Code Ann. § 65-5-209. On September 20, 1995, the TPSC approved a price regulation plan submitted by UTSE. Any increase in UTSE's rates subsequent to the TPSC approval must follow the provisions of § 65-5-209(e), which states:

A price regulation plan shall maintain affordable basic and non-basic rates by permitting a maximum annual adjustment that is capped at the lesser of one half (1/2) the percentage change in inflation for the United States using the gross domestic product-price index (GDP-PI) from the preceding year as the measure of inflation, or the GDP-PI from the preceding year minus two (2) percentage points. An incumbent local exchange telephone company may adjust its rates for basic local exchange telephone services or non-basic services only so long as its aggregate revenues for basic local exchange telephone services or non-basic

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- (i) The amount by which the embedded cost of providing residential basic local exchange telephone service exceeds the revenue received from the service, including the cost of the carrier-of-last-resort obligation, for both high- and low-density service areas;
 - (ii) The extent to which rates for residential basic local exchange telephone service should be required to meet the standards of § 65-5-208(c); and
 - (iii) Intrastate access rates and the appropriateness of such rates as a significant source of universal service support.

⁵ *Consumer Advocate Division, on behalf of Tennessee Consumers and the Attorney General of Tennessee v. Tennessee Regulatory Authority*, Appeal No. M1999-01699-COA-R12-CV, TRA Docket No. 98-00626, *Order Denying Petition for Rehearing* (January 24, 2000), 2000 WL 1514324 at *1 (Tenn. Ct. App. Oct 12, 2000).

⁶ *Id.*

services generated by such changes do not exceed the aggregate revenues generated by the maximum rates permitted by the price regulation plan.⁷

Tenn. Code Ann. § 65-5-209(f) also limits the maximum amount of increases in rates permitted annually as follows:

Notwithstanding the annual adjustments permitted in subsection (e), the initial basic local exchange telephone service rates of an incumbent local exchange telephone company subject to price regulation shall not increase for a period of four (4) years from the date the incumbent local exchange telephone company becomes subject to such regulation. At the expiration of the four-year period, an incumbent local exchange telephone company is permitted to adjust annually its rates for basic local exchange telephone services in accordance with the method set forth in subsection (e) provided that in no event shall the rate for residential basic local exchange telephone service be increased in any one (1) year by more than the percentage change in inflation for the United States using the gross domestic product-price index (GDP-PI) from the preceding year as the measure of inflation.⁸

Procedural History

On May 29, 1997, the Authority convened Docket No. 97-00888 (*In re: Universal Service Generic Contested Case*) to establish an intrastate Universal Service funding mechanism pursuant to Tenn. Code Ann. § 65-5-207,⁹ 47 U.S.C. §214 (Supp. 2000), and FCC Order 97-157.¹⁰ The purpose of such a funding mechanism is “to ensure telecommunications services for low-income, rural, insular and high-cost areas at a cost comparable to those in urban areas for similar services.”¹¹

⁷ Tenn. Code Ann. § 65-5-209(e).

⁸ Tenn. Code Ann. § 65-5-209(f).

⁹ Tenn. Code Ann. § 65-5-207(b) provides for the establishment of “a generic contested case proceeding to determine the cost of providing universal service, determine all current sources of support for universal service and their associated amounts, identify and assess alternative universal service support mechanisms, and determine the need and timetable for modifying current universal service support mechanisms and implementing alternative universal service support mechanisms.”

¹⁰ See *In Re: Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, FCC 97-157, 12 FCC Rcd. 8776 (May 8, 1997) (Report and Order).

¹¹ *In re: Universal Service Proceeding*, TRA Docket No. 97-00888 (Order Establishing Intrastate Discounts for Schools and Libraries Pursuant to Section 254(h) of the Telecommunications Act of 1996 and FCC Order 97-157) (September 18, 1997) p. 2 (hereinafter *September 18, 1997 Order*).

Also on May 29, 1997, the Authority convened Docket No. 97-00889, to consider the *Petition of AT&T Communications of the South Central States, Inc. for the Convening of a Generic Contested Case for the Purpose of Access Charge Reform*. In its *Petition*, AT&T contended that the current system of assessing access charges upon interexchange carriers such as AT&T, which is presently based on the perceived revenue needs of the incumbent local exchange carriers (“ILECs”) rather than the cost of providing service, fosters a policy inconsistent with competition.¹² AT&T maintained that this practice is anti-competitive and discriminatory because it creates a “price squeeze” of artificially inflated access costs which favor ILECs over interexchange carriers.¹³

The Joint Petition of UTSE and AT&T

UTSE and AT&T (collectively the “Petitioners”) initially filed their *Joint Petition* on June 1, 2000 in both of the aforementioned dockets, Docket No. 97-00888 and Docket No. 97-00889. Docket No. 00-00701 was opened on June 1, 2000 specifically for the Authority to consider the *Joint Petition* filed by the Petitioners.

According to UTSE and AT&T, the *Joint Petition* proposes “to accomplish the goals of Universal Service by rebalancing [UTSE’s] rates rather than through creation and administration of a separate fund.”¹⁴ The Petitioners request an increase in Local Service Rates in order to reduce Access Charges. Specifically, they propose to reduce switched access rates by \$1.5 million on October 15, 2001 and by \$1.3 million on October 15, 2002. In conjunction with these reductions, UTSE proposes to increase its residential and business basic local exchange rates by the same amount, resulting in an average monthly increase in residential flat rates of \$1.01.

¹² See *Petition of AT&T Communications of the South Central States, Inc. for the Convening of a Generic Contested Case for the Purpose of Access Charge Reform*, Docket No. 97-00889, ¶ 12.

¹³ See *id.* at ¶¶ 12, 23.

¹⁴ *Joint Petition*, p. 7.

Further, under this proposal, UTSE agrees to forego any Universal Service funding through October, 2002.

The Petitioners assert that their proposal creates an “alternative universal service mechanism” within the meaning of Tenn. Code Ann. § 65-5-207(c).¹⁵ They argue that the increase in rates would remain affordable given the length of time since a general increase in basic rates was imposed. They also predict that customers using long distance will enjoy reduced toll rates under this proposal.¹⁶ In addition, UTSE and AT&T maintain that the proposal would eliminate any basis for challenging UTSE’s access charges under the provisions of Title 65 of the Tennessee Code prohibiting discrimination and anticompetitive practices and would avoid the cost of administering a Universal Services fund.¹⁷

There were no intervenors in this docket.

Findings and Conclusions

At the February 21, 2000 Authority Conference, the Directors voted unanimously to deny the *Joint Petition* filed by UTSE and AT&T. The Authority found that the Petitioners’ proposal contravenes state law, specifically Tenn. Code Ann. §§ 65-5-207 and 65-5-209, and is not in the public interest.

The Petitioners’ proposal ignores the limiting language of § 65-5-207(c), which authorizes the creation of

an alternative universal service support mechanism that replaces current sources of universal service support **only if** . . . [the Authority] determines that the alternative will preserve universal service, protect consumer welfare, be fair to all telecommunications service providers, and prevent the unwarranted subsidization of any telecommunications service provider’s rates by consumers or by another telecommunications service provider. (Emphasis added).

¹⁵ *Id.* at 11.

¹⁶ *Id.* at 9.

¹⁷ *Id.* at 10.

The Petitioners have not provided support for their contention that their proposal creates an “alternative universal service support mechanism” and have failed to make even a preliminary showing meeting any of the statutory criteria required for the creation of such a mechanism. Nor does the proposal satisfy the requirements of § 65-5-207(c)(1) through (8).¹⁸ For example, the Petitioners provided no support showing the financial effect on each Universal Service provider caused by the creation of such an alternative Universal Service mechanism or the amount by which the embedded cost of providing residential basic local exchange telephone service exceeds the revenue received from the service.¹⁹ The Authority thus concludes that the proposal is not consonant with the requisites of Tenn. Code Ann. § 65-5-207.

Further, the Petitioners provided no support for their contention that the proposed rate increase would not render basic rates unaffordable under “any standard.”²⁰ The Petitioners presented no standard, analysis, or study measuring affordability. The Petitioners have not offered any explanation of their contention that their proposal would eliminate the cost of administering a Universal Service fund. The fact that under their proposal UTSE and AT&T are the only telecommunications service providers intending to forego universal service contributions under their proposal undermines this contention.

Moreover, the proposed increases to residential basic local exchange rates violate the statutory prohibition against making, imposing, or exacting “any unreasonable, unjustly discriminatory or unduly preferential individual or joint rate, or special rate, toll, fare, charge, or schedule for any product, or service supplied or rendered by it within this state.”²¹ Specifically, the Petitioners seek an increase in rates beyond that contemplated by Tenn. Code Ann. §§ 65-5-

¹⁸ See footnote 4, *supra*.

¹⁹ See Tenn. Code Ann. § 65-5-207(c)(5) and (8)(i).

²⁰ *Joint Petition*, p. 11, ¶ 1.

²¹ Tenn. Code Ann. §§ 65-5-204(a)(1); see also 65-5-209(a), (e) and (f).

209(e) and (f). The Authority recently approved UTSE's 2000 price cap.²² The adjustment for inflation contained therein was three percent (3%). The Petitioners assert that the average monthly residential rate increase will be \$1.01. Applying this \$1.01 increase to UTSE's existing basic local exchange residential rates results in increases ranging from 7.7% to 11.8%. The Authority thus finds that the proposal violates Tenn. Code Ann. § 65-5-209.

The Authority further finds that the adoption of the Petitioners' proposal would not serve the public interest. The Petitioners claim that customers of UTSE who use long distance will benefit from a reduction in toll rates resulting from the interexchange carriers' flow-through of the savings on access rates to its customers. Although some high-volume toll users would receive decreases in their telephone bills, the proposal would impose an overall increase in the rates of the majority of UTSE customers. Under the proposal, UTSE customers would pay an additional \$2.8 million in local rate increases without enjoying the total \$2.8 million in access charge reductions, because the access rate reductions would be dispersed to customers throughout the State, not just to those in UTSE's territory. UTSE's customers would pay all of the rate increases without realizing an equivalent reduction in access rates.

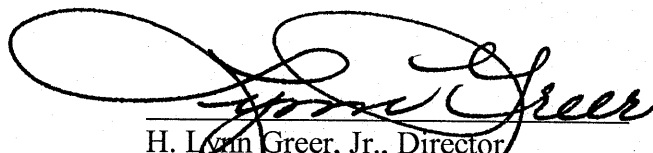
Finally, by seeking rate changes in lieu of establishing a Universal Service fund, the Petitioners' proposal undermines a primary purpose of Universal Service, to wit: to encourage competitors to serve customers in high cost areas. Without Universal Service funds, competitors may not be financially able to serve customers in high cost areas. In light of these facts, the Authority does not find that the proposal will preserve Universal Service or protect consumer

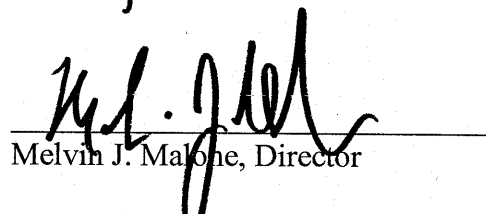
²² See *United Telephone-Southeast 2000 Annual Price Regulation Filing*, TRA Docket No. 00-00949, *Order Approving Price Regulation Filing*, p. 2 (March 14, 2001).

IT IS THEREFORE ORDERED THAT:

The Joint Petition of United Telephone-Southeast, Inc. and AT&T Communications of the South Central States, Inc. is denied.


Sara Kyle, Chairman


H. Lynn Greer, Jr., Director


Melvin J. Malone, Director

ATTEST:


K. David Waddell, Executive Secretary